RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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May 16, 1984 *LETTER 887*

MAY 4, DJIA 1165.31; PTI 1656; A-D ratio –18.76
MAY 11, DJIA 1157.14; PTI 1644; A-D ratio –19.24

THE MARKET: I wrote a good part of this Letter from beautiful Monterey, California, where I spoke at the annual meeting of the Market Technicians Association. This was the MTA's biggest turnout (about 220 members) and their first Western meeting. In the lead-off speech I talked about Charles Dow and the rise of the Dow Theory and technical analysis. Two days later I gave a second speech, presenting my views of the market. In between I enjoyed Monterey and nearby Carmel (Carmel's local bank just went belly-up and was the talk of the area newspapers).

An interesting vote was taken by the MTA members on the path of the market one year from now. The majority voted bullish for the Dow level (up 10 percent or more) a year from now. Only 12 members guessed that the Dow would be down 10 percent in a year and another 12 voted the Dow lower by 20 percent a year from now. The contrary opinion was therefore a bearish one. Few members of the prestigious MTA saw the Dow down as much as 10 to 20 percent one year hence. Remember, the market has a nasty habit of doing what the fewest number of investors are prepared for.

And so, on to the stock market. I want to deal again with the major picture, and for this I will review the five methods which I use to gauge the direction of the primary trend.

(1) The Dow Theory rendered a bear signal on January 8, when the D-J Industrial and Transportation Averages jointly broke below their August lows. The primary trend was reconfirmed as bearish when, on April 6 (see Letter 885) the two Averages again broke to new lows. On any reading of Dow Theory, the primary trend must now be considered down.

The puzzle in the picture (and this is no part of Dow Theory) is that neither the D–J Utility Average nor the S&P 500 nor the NYSE Composite has confirmed on the downside. All have held above their February lows. I can only conclude that in due time these three will follow the Dow Averages to new lows. The market has its own way of keeping us guessing and hoping.

(2) Lowry's Buying Power/Selling Pressure study went over-sold in late February and has given a preliminary buy signal. But the longer term selling pressure line is still above the buying pressure line. Nevertheless, Lowry's is the most hopeful of the five studies which I use.

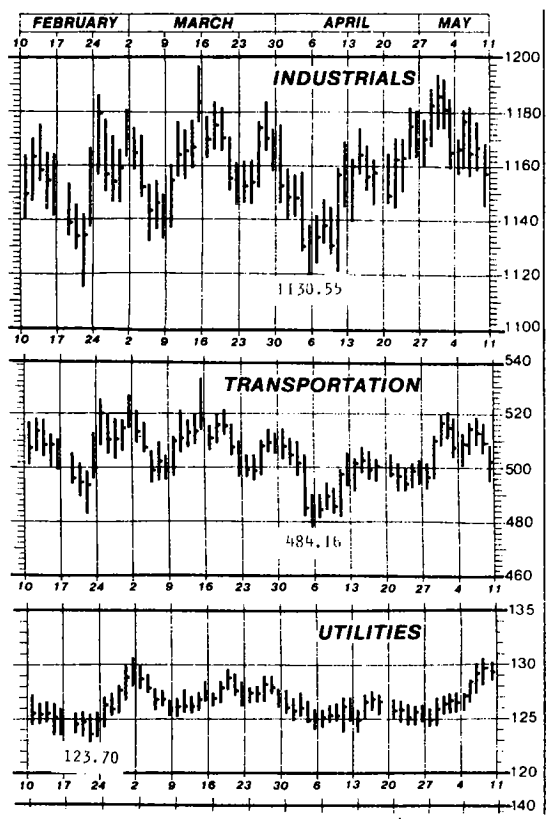
(3) The Trendex Longterm Probability Index remains bearish. The longterm sell signal came on Feb. 1, 1984.

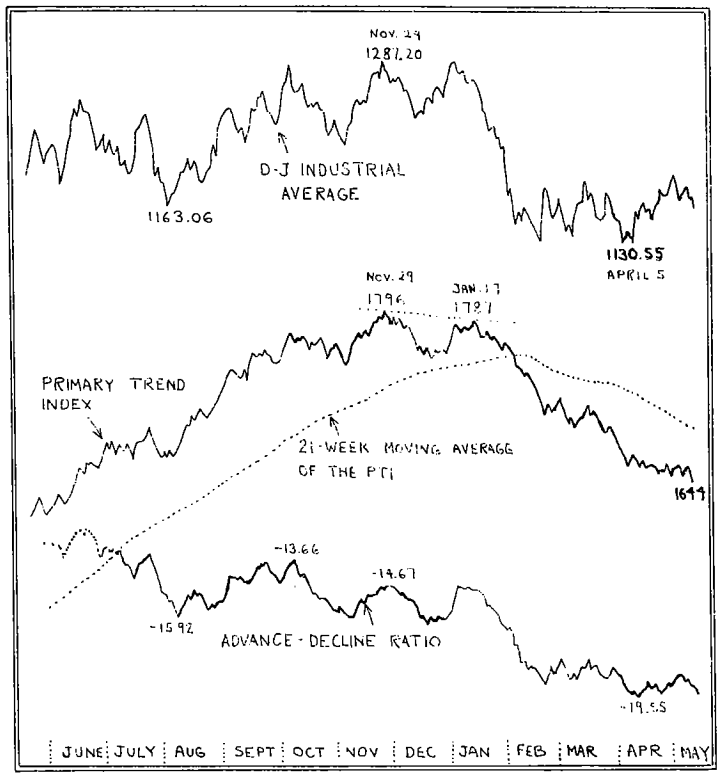
(4) The latest (May) Bank Credit Analyst is bearish and states that "general deterioration remains evident, although the pace of such deterioration is not necessarily picking up. ... On an intermediate-term view both bonds and equities are vulnerable."

(5) Last but not least, my Primary Trend Index (PTI) has formed what appears to be a huge head-and-shoulders top (see pg. 2 chart). Any rally from here (and a rally would "seem" to be overdue) would probably build a right shoulder on the PTI, thereby making the overall picture even more bearish. So to put it simply – the PTI is in the bearish mode.

Conclusion: The primary trend of the stock market is down. A rally may be overdue, but such a rally would be against the prevailing major trend. I never advise in-and-out trading or trying to beat the primary trend of the market. The object here is to conserve assets, not scalp a few short-term profits. Thus, we are on the sidelines, a position suggested in the "Investment Position" box in all recent Letters.

Interestingly, the PTI is now leading the market down. On May 10 the PTI broke to a new low below the 1656 level, a level that had been tested on three previous occasions. On May 11 the PTI broke again, this time to 1644. This is bearish action, and as I've written many times before, a *persistent trend* (up or down) in the PTI will in due time take the rest of the market with it. We now have a persistent downtrend in the PTI, and the situation is decidedly bearish.





With the PTI hitting new lows, all eyes are on the holdout indices. Bearish confirmation would entail the D-J Utility Average breaking to a new 1984 low below 123.70. It would also entail the S&P 500 breaking 174.10 and the NYSE Composite dropping below 88.69.

Meanwhile, the A-D ratio (which is a proxy for the entire NYSE) closed on May 11 just fractionally above its 1984 low of minus 19.55 (see pg. 2 chart). A few more weak days in breadth would therefore push the A-D ratio into the bearish-confirmation camp.

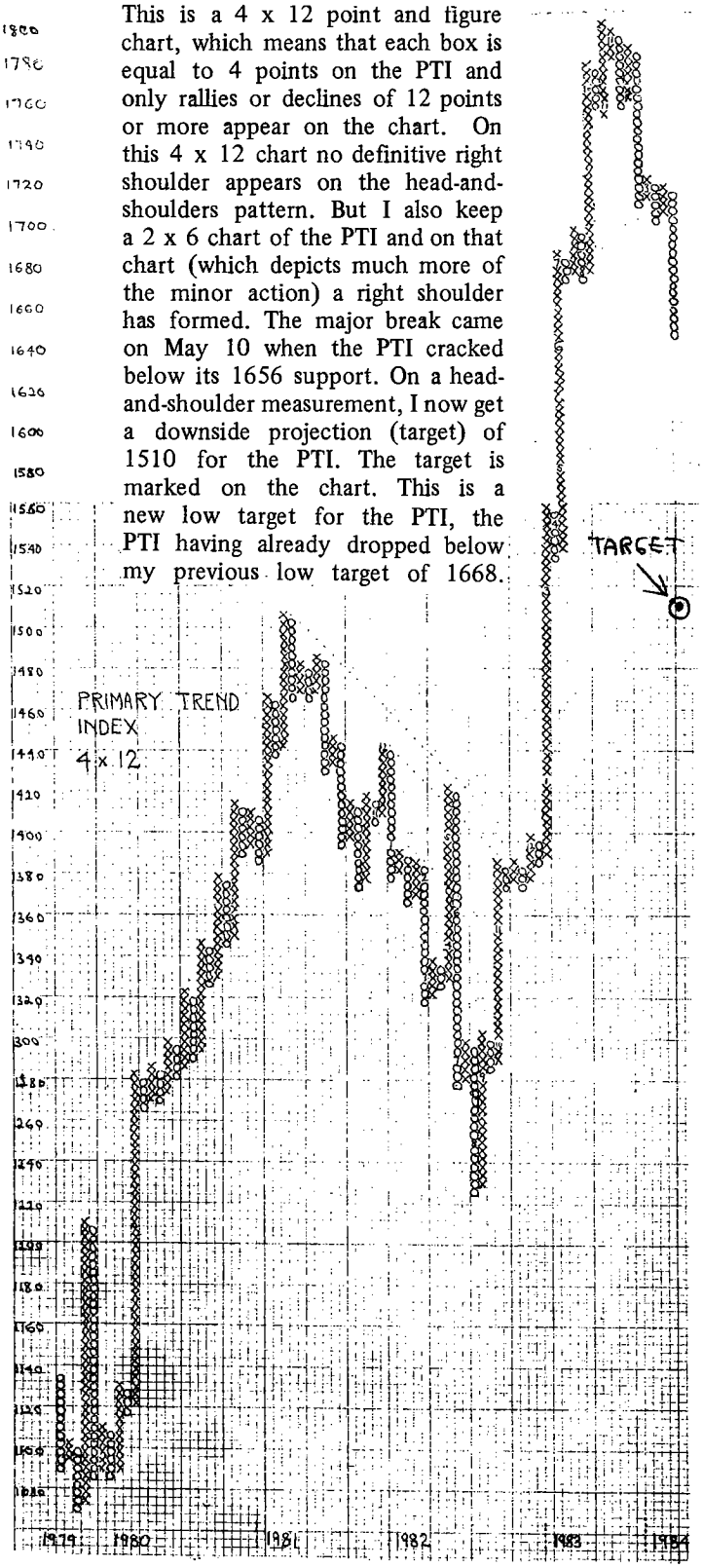
A final note: Probably the easiest way of automatically following the longterm trend of the market is to follow the trend of the 21-week moving average of the PTI. The 21-week MA turned down on Feb 7. And as you can see on the chart, the 21-week MA has been trending steadily lower ever since.

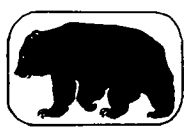
INVESTMENT POSITION: Remember about four years ago (when gold was near its high) and everyone was saying, "Borrow to the hilt. Owe everyone, because you'll pay off with cheap, worthless dollars!" Remember that? And here we are in 1984, and everyone is borrowed to the hilt. And darned if it isn't the savers who are in the saddle. The people with cash now have a mouth-watering selection of places to go, with all kinds of money instruments providing the highest REAL interest rates in history.

Today you can get 10 percent to 13 percent on your money in Treasury obligations. And you can get 9.2 to 10 percent on your money in tax-exempt AA quality bonds. At 9.5 percent you can double your money in less than eight years and not owe a nickel in taxes. Under those conditions, it becomes awfully hard to buy stocks. As to the guy who is up to his ears in debt, good luck. I've been talking liquidity ever since 1980, and I'm still talking liquidity. To my mind, CASH and INCOME are the operative words for the rest of the 1980s. How do I know? I know because few people have much of either.

How do you get cash? You get it by spending less than you earn. How do you get income? Buy the general obligation bonds of the state in which you live. If you're worried about our nation and its obscene deficits, buy bonds to mature in five years or even less.

This is a 4 x 12 point and figure chart, which means that each box is equal to 4 points on the PTI and only rallies or declines of 12 points or more appear on the chart. On this 4 x 12 chart no definitive right shoulder appears on the head-and-shoulders pattern. But I also keep a 2 x 6 chart of the PTI and on that chart (which depicts much more of the minor action) a right shoulder has formed. The major break came on May 10 when the PTI cracked below its 1656 support. On a head-and-shoulder measurement, I now get a downside projection (target) of 1510 for the PTI. The target is marked on the chart. This is a new low target for the PTI, the PTI having already dropped below my previous low target of 1668.





VALUES: The study of values is one of the most fascinating areas of the market. "To know values," wrote Charles Dow, "is to know the meaning of the maket." My own personal view is that Dow's words were never more pertinent to investing.

Why do I say that? I say it because I believe that the operative word for the rest of the 1980s is going to be INCOME. This is another way of saying that I think from here on we are going to be in a struggle to retain our standard of living.

The debt structure of this nation is now at the level where it is squeezing the nation and its citizens. On May 1 "Freedom Day" was announced by the Tax Foundation. This means that the American citizen has been working for government taxes from January 1 to May 1, and after May 1 he was working for himself. The total tax take from all government sources has now gone over one trillion dollars.

My feeling is (and I am sorry to say this) that we are now seeing the lowest taxes that we will see in our lifetimes. There is currently much talk about "flat taxes", "value added taxes" and all varieties of "more equitable" taxes. But as I've stated recently, the vested interest in the current tax system is monumental. Today there are armies of lawyers, tax shelter specialists, accountants, planners on one side, plus an army of IRS agents and tax creators on the other side. Also, we must remember that most members of Congress are lawyers, and thus there is a built-in bias toward any system that makes more work for lawyers.

This makes me think that regardless of desirability of totally changing our tax system, the odds are that the system will remain intact. There will be embellishments and new additions to the tax system during 1985, but one way or the other, our taxes are headed higher. Why? Simple, the government's expenses are going higher.

President Reagan entrusted the Grace Commission under Peter Grace to map out plans for cutting government expenses. The Commission did a fabulous job and came up with ideas for saving $423 billion over three years. To my knowledge, very few of these ideas have been adopted. Congress acted as if it had never heard of the Grace Commission.

Thus, my prediction: we are now experiencing the lowest taxes that we will see in our lifetimes. From that comes my second prediction, and it is that *income* is going to be the operative word for Americans during the rest of the 1980s.

If you can accept that, it might be worthwhile going into a few interesting statistics. The average dividend yield on the D-J Industrial stocks is 4.75%. The average yield on the much broader Value Line stock index is 3.7%. The yield on Moody's AAA corporate bonds is 12.8%. The Average yield on California State AA general obligation bonds (tax exempt) is 9.5%. The yield on T-bills (91 days) is 9.6%. The yield on long term T-bonds is 12.9%.

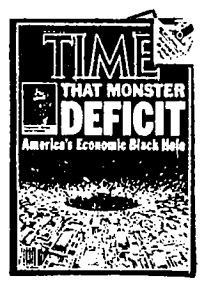
Let's see what happens to a few of these items in five years. At 4.75% compounded, $1,000 in the Dow becomes $1,264. At 3.7% the Value Line in five years becomes $1,199. At 12.8% $1,000 in T-bonds becomes $1,826. At 9.5%, $1,000 in T-bills becomes $1,581. And at 9.5%, $1,000 in AA California State bonds becomes $1,581.

Remember, all these figures are based on the premise that you can reinvest at the same rates, and that no taxes are paid. If you pay taxes, cut the increases by at least a third. Except, of course, in the case of the muni bonds which draw no Federal taxes (and no state taxes if you buy bonds from your state).

Taking the Dow, let's say that you pay out one-third of your dividends each year in taxes. That means that if the Dow stands still your investment of $1,000 in the Dow will be worth roughly $1,194 in five years, an increase of almost 20% based on dividends. But the California munis (with no taxes) will have increased by 57%. Thus, to match the munis the Dow will have to climb roughly 35 to 40% over the next five years. Can it happen? Can the Dow rise to 1566 by 1989? Sure it can happen. But remember, aside from the taxes on dividends you would have to pay capital gains taxes on the Dow if you sold out at 1566 in 1989. Under those conditions, the Dow would have to rise even more than 40% to equal the return on the munis.

And this gives us some idea of why the muni sector of the market has been one of the strongest sectors during 1984. Mathematics and the magic of compounding tax-free interest now renders an investment in high-grade munis very attractive. If taxes go higher, the muni investment becomes that much more attractive.

INTEREST RATES: Probably the most fascinating situation in the markets today is the interest rate picture. Why is this so? It's so because according to many, today's high interest rates are a contrived situation brought on by the Fed. According to this view, the Fed possesses only one "club" with which it can pressure Congress to act on the horrendous budget deficits. That weapon is pressure on interest rates. Repeatedly, Fed Chairman Volcker has told Congress that a reduction of roughly $50 billion in the Federal deficit would mean a reduction of 1% in the interest rates.



The stock market may sense all this, and the general Wall Street view is that if interest rates go down, the stock market will explode. So all Wall Street is waiting anxiously for the demise of the rates.

What are the arguments for lower rates? (1) Everybody is now talking about the deficit. According to contrary opinion, when everybody and his brother is focussed on one theme, that theme is over. The ultimate test of this contrary thesis is supposed to be Time Magazine. When an item finally appears on the cover of Time, states this thesis, the story is out and over. At any rate, on March 5 Time came out with its big "Monster Deficit" story, and many hoped that this would mean that the deficit was last year's worry.

(2) The latest national inflation figure (annualized) was 3.7%. According to the generally accurate economists, S. Jay and David A. Levy (Industry Forecast, Box 26, Chappaqua, NY 10514) there will be a "near absence of inflation" this year. The "worst case" that the Levys see for 1984 is about 3% inflation. If this is true then real interest rates (current rate minus inflation) are now running at 6% for T-bills and 9% for T-bonds, record highs.

Normally, the real rates run about 3% above the inflation rate, and this means that rates generally today are about 3% "too high." This phenomenon should ordinarily be bullish for the

money markets, and indeed the Levys in their latest report stated that "a sharp decline in interest rates is in the offing."

(3) Many believe that the Fed is seriously worried about the possibility of a new inflationary surge. This, they say, is why the Fed is still putting pressure on the money markets. But "the Fed is dead wrong," say these experts. Actually, they point out, the leading indicators are turning down, housing starts have suffered a record drop, auto sales are leveling off, and corporate profits have probably peaked out. Therefore, as soon as the Fed sees it is fighting the wrong war it will ease up considerably.

(4) Finally, this is a Presidential election year, and history shows that prior to Presidential elections the Fed works for the incumbent. This means easy money in the second half of 1984, and with inflation now around 3% a Fed move toward ease should result in a swan dive for interest rates.

But there is one big hole in this argument. Here it is. Mr. Volcker and the Fed have been fighting inflation for five years. This has been the first Board in recent history that has gained credence from Wall Street. Now comes the election, and the "expected" is for the Fed to open the money spigots and put pressure on to reduce interest rates. But, say the cynics, is it logical that after a five year anti-inflation fight Mr. Volcker and the Fed members will let it all go down the drain and fan the fires of inflation? No, the history of the last five years suggests that Volcker will hang tight.

The proof: here in an election year long-term T-bonds are at 13%, and T-bills yields are near 10%. As yet, there is no hint of a collapse in interest rates, and experts like Henry Kaufman are talking about further boosts in Fed Funds and interest rates.

Of course my own opinion is that the Fed is merely following the market rates up. The market (and I've said this many times before) is now taking over; and it's the markets that are telling the politicians what to do.

And we might ask, "Who is killing the great stocks of America?" and the answer, of course is that "The great bond interest rates of America are killing the great stocks." The ever more-frequent and the ever larger Treasury financing packages are rocking the bond market to its toes. When will it all end? Nobody knows, least of all Congress.

DEFENSE: One of the biggest and very probably the most expensive (long term) projects in US history is being openly debated today. This is the high energy beam program that was discussed in Letter 871 by my friend, Melvyn Lippman of US Organization Chart Service of La Jolla. The program has to do with high energy beam defense against ballistic missiles. So important is this whole concept that I am repeating Lippman's excellent and incisive dissertation of the weapon in this Letter.

The development of a high beam ABM program would cost $500 billion to $1 trillion. It can be likened to five Manhattan Projects (this is the project that produced the first atomic bomb). Research and development on the high energy program is NOW going via the Defense Department (Defense Advanced Research Project Agency under Richard DeLauer).

The debate rages. (*Time* Magazine May 7) presented a two page essay arguing that the beam system should not be developed. Time's argument is that "today is the worst possible time for the superpowers to carry their competition into space–or even to threaten to do so." But Time naively must believe that if we don't develop the program, the Russians won't either. The fact is that the Russians are already deep into the beam program. For the US to stick its head in the sand at this time would be suicidal.

Many groups are now opposing the beam concept. But the one fact that they all ignore is the vital fact–the Russians are going full speed ahead on their beam program. To pretend they are not is the height of absurdity. I am including Lippman's piece below because I consider it vital for my readers to understand what is happening in this area. Since this piece was written (Oct. 6, 1983), it has assumed even greater importance. The future of the US may depend on the concept of directed energy weapons.

Question: Mel, you've talked to me about a whole "new US military." You've mentioned concepts that will turn everything we see today in the military into antiques. Would you elaborate, please?

Answer: We're moving into the area of what I term "the all new US military." The technology is emerging. To think it could not happen will prove to be a fatally dangerous notion.

The USSR in the immediate future will attempt to militarily break-away and thus force the United States to accept permanent military inferiority. America's very major hope in preventing this lies with its Research, Development, Test & Evaluation (RDT&E) programs. This fact, this hope, is receiving increasing recognition within the Department of Defense. In Fiscal year 1982 the defense budget provided $20 billion for RDT&E of which $13.6 billion was performed by private industry. Fiscal year 1983 RDT&E is estimated at $22.8 billion of which $15.8 billion will be performed by private industry. And for fiscal year 1984 it is estimated RDT&E will be $29.6 billion, an increase over the last two years exceeding 30%, and $21.9 billion will be performed by industry. This trend is in the initial phase and will continue for years to come.

One extremely important military research effort the United States is engaged in is the Directed Energy Program. This has many startling military capabilities; one is the High Energy Laser Program. A directed energy weapon is one that generates radiant energy or energetic particles, focuses them into narrow beams, and points and delivers them to targets. This energy may come from chemical fuel, electrical power, intense sources of heat or high explosives. The beams consist of charged or neutral atomic particles or electro-magnetic radiation and are capable of near-instantaneous delivery to targets. A directed energy weapon, in general, would consist of an energy source, a device such as a laser or particle accelerator, optical systems to direct and focus the beam, and the means to acquire, track and point at several targets in the span of seconds. These energy weapons have a wide array of applications and may be ground, sea, air, or space based. Directed energy weapons might be used as a stand-alone or as a part of a defense-in-depth concept. A single directed energy weapon could be designed with the capability of knocking out tens of targets in a relatively short period of time.

The potential contributions of directed energy weapons are significant. They would introduce new vulnerabilities to the USSR's arsenal of strategic weapons and therefore introduce new uncertainties in the Soviets' ability to achieve their objectives. They could (1) engage and defeat limited nuclear strikes by destroying Soviet ballistic missiles in the vulnerable boost phase, (2) provide us with many new response options, (3) selectively thin out

attacking missiles and aircraft, and (4) aid United States strategic force retaliatory strikes by destroying a large portion of the USSR's air defenses. These are some of the attractive benefits for using directed energy weapons in the air, on land and the high seas.

Further, there are some obviously attractive benefits for using laser weapons in space. Outside the atmosphere the laser has the potential to transmit damaging energy at the speed of light over very long distances. Directed energy weapons could deny the use of space to the Soviet military while protecting America's space assets. Furthermore, lasers are not weapons of mass destruction. They direct energy to a prescribed target area and nowhere else.

The Space Laser Program is one of several directed energy research programs now underway by the Department of Defense. The technical maturity of these programs ranges from early in the proof-of concept phase to approaching the maturity necessary to enter the formal weapon development program. The Department of Defense intends to spend about $900 million by fiscal year 1988. A remarkable increase in this funding figure could occur. The 1984 defense budget as approved and signed by the President has authorized over $134 million for laser beam anti-missile systems technology alone!

Prime responsibility for this new technology lies with the Department of Defense's Defense Advanced Research Projects Agency, Lawrence Livermore and the Los Alamos National Laboratories. Private industry is joining in the partnership and will have an increasingly larger role in its research and development. As in most development programs, the present focus is on two basic issues—are such weapons feasible, and, if they are, at what cost? The efforts to resolve these issues are extensive because (unlike familiar weapon forms such as guns and aircraft) the United States for the first time is addressing brand new weapon forms that have never been developed and deployed before.

Directed energy weapons will make a very major contribution to the US's defense posture. This new technology, in addition to other research programs, has the potential of providing America with a giant leap forward into completely new defense weapon systems that will give the US the capability of partially closing the widening military weapons gap which presently favors the USSR.

Research, development, hi-technology, advanced technology; these have always been part of America's strengths and they have always guaranteed her tomorrows. There are reasons to think (to hope) this may continue to be. It requires the spending of a great deal of America's time, treasure and talent. But there are no guarantees; there never have been.

AMERICAN SLEAZE: It's generally accepted that youth loves to shock its parents. I spent my high school days in the swing and "black jazz era." That was the era (1938 to 1942) when swing, Benny Goodman, Gene Krupa, jitterbugs, etc. caused parents to shake their heads in bewilderment. When swing became accepted, jazz took over, and we "insiders" went down to 52nd Street (NY) or up to Harlem to hear the greats such as Coleman Hawkins, Roy Eldridge, Teddy Wilson, Art Tatem.

Came the war, and all that ended for me. My own shocks came from seeing my buddies blown out of the Italian skies. After the war I finished up college at NYU (I had a year prior to the war at Rutgers). The next shocker came from Jack Kerouac and the "beats" (I had gone to school with Kerouac, and his book, "On The Road" became the new battle cry of youth who wanted to shock their parents). Karouac's friend, John Burroughs wrote the bible of the druggies, "Naked Lunch." The dope generation was on its way.

I used to listen (I guess it was around 1959-60) to a disc jockey named Alan Fried. Fried started a trend toward a brand of music called rock and roll, which was really a white version of black music termed rhythm and blues. Obviously, the new rock and roll (along with Elvis' revolving hips) shook the older generation. They had never seen anything like it.

Came the 1960s, and with it heavy rock, nudity, open sex, dope for everyone and the emergence of the hippies. Out of the hippie movement grew the Vietnam protest, and out of that murmur grew a roar that shook every President from Kennedy on. The country itself went into shock when Nixon toppled from his throne.

What was left to shock the elders? In my opinion, today's shocker (if we are still open to shock) is sleaze. Sleaze is what today's kids attempt to shock their parents with and the essence of teenage sleaze is the "punks" with their red and purple hair, the pins through their ears and the torn clothes or no clothes.

But not to be outdone, the elders have produced their own brand of sleaze. We see it everywhere in government, as investigations produce evidence of graft, corruption, bribe-taking, pay-offs, extortion and theft.

My home town has not escaped the sleaze blitz. In fact, the way San Diego is going, it could well become the sleaze capital of the US. Our own Mayor Roger Hedgecock is being investigated for various irregularities, including whether $340,000 given by a now-defunct brokerage firm was illegally funneled into the mayor's campaign fund. The defunct brokerage house was headed by David Dominelli, a man who apparently ran off with about $150 million of investor's money. When last heard of, La Jolla's Dominelli bolted for the Caribbean, and was then brought back to San Diego's own county jail. Currently, all San Diego is waiting for the next chapter in this home-grown melodrama. Come to think of it, Mr. Ed Meese is also a San Diegan. . . . .

Outside of the usual stealing we see sleaze in such disgusting pursuits as child molesting, dope dealing, mugging, violence of every kind and descriptions, and a seeming national breakdown in morality. Some say (and I'm not sure they aren't correct) that whenever government snatches over one-third of the citizens' income via taxes, a breakdown of society occurs. If so, we are there.

Hollywood too has entered the sleaze arena with a vengeance (Hollywood always produces what it feels reasonably certain it can sell). I was therefore rather struck with the LA Times review of "Friday the 13th, The Final Chapter"(April 16). Here's a paragraph from the review.

> These young people regarded its incessant graphic slaughter as a laugh riot, yet there's nothing tongue in cheek in its presentation of one violent death after another. Such a response does give you pause: 'There must be an awful lot of anger and frustration out there to elicit such a reaction. Possibly such sick trash is cathartic in effect, but it's hard not to suspect that it's more an instance of people merely having become inured to the depiction of the extreme suffering of others.

You know, I've lately come up with a theory (and I'm deadly serious about this). The theory is this: the biggest problem in the world is the lie. Most of the world, from the Russians to many of our politicians, to our next door neighbors live by the lie.

We lie to our husbands, our wives, our kids, our bosses. We tell people what we think they want to hear or what's safe or what we think will do us the most good. We lie by ommision, we lie by cover up, we lie as easily as we breathe the air.

But I'm firmly convinced that if everyone lived by the truth, the painful truth, the bitter truth, the absolute truth, ALL the world's problems would disappear within a generation. "Know the truth and the truth will set you free," said Jesus. And maybe that's the single greatest truth of all. I'll let you in on something I've discovered. I've never seen the truth blow up anything worth preserving. I've never seen any major and lasting harm caused by a telling of the utter, unmitigated truth. I've only seen healing good things come from the truth.

NOTES & QUOTES: One of the guys in my high school class (Horace Mann in NYC, '42) was Salim Zilkha, of the famous Paris and Zurich banking family. In the May 7 Forbes there is an interesting interview with Ezra Zilkha, Salim's father. Asked about what he sees ahead, the great banker offered the following prophecy: "The way I think the world will end is not in financial collapse. It is like this: Someday everyone in the world will have a car, and they will all get caught in a huge traffic jam and be unable to move. Then they will all have to fill out some government form for it, and they will be unable to do that either, because the form is so complicated. And that will be the end of the world."

* *

Quote of the week: From a May 3 USA Today interview with Steve Allen:

USA TODAY: Doesn't television have a history of treating its talent unfairly, or even destroying it?

ALLEN: There is no television. There is no head. There is no god in television. It is just a big machine, a big process. The people who we might think of as gods — the people who head an NBC, or ABC, or CBS this year — get fired in three or four years. There is nobody at the top. There is no soul. There is no moral center of gravity to television. So there's nobody to shake your fist at and say, "Damn it! Why didn't you treat Sid Caesar better?" There was nobody there doing the treating. It's just, "This show is canceled; let's do this commercial; now we'll have lunch." It's a process. There's nobody to blame.

* *

Shock: As I've noted here before, the US is no longer the undisputed leader in Free World technology. The May 7 New York Times front-pages a story to the effect that US companies now realize that they must monitor Japanese technology or lose out in many areas of world trade. US visitors to Japan have been surprised by Japanese advances in such fields as optical communication, data storage, computer memory chips and advanced automation. Several US businessmen stated that they were "frightened" at the technology advances they had seen on visits to Japan. One of the problems, the article stated, is that Americans suffer from the delusion that if it's not done in America, it's not important.

* *

Statistics always have fascinated me. Here are a few that I thought worth repeating.

General Motors current inventory of cars and parts: $8.3 billion (that's right, billion).

Size of the US lawyer population: 650,000.

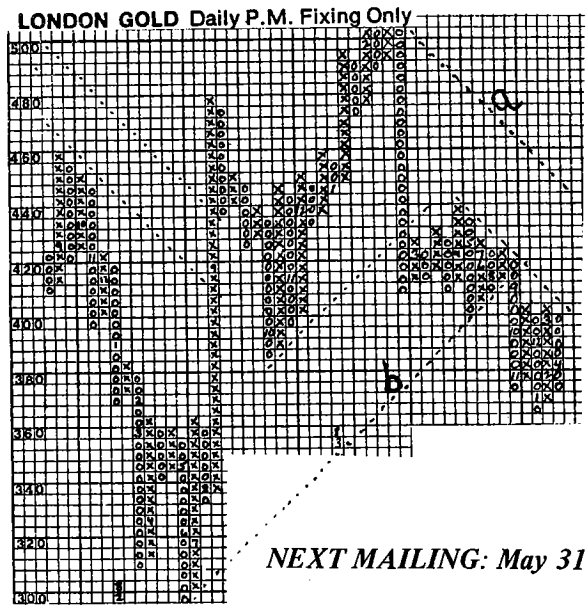
Number of manuscripts submitted to US publishers each year: 400,000. Number that are published: 40,000.

GOLD: Gold and the precious metals sink reluctantly lower. But many of the S. African gold shares are now higher than they were when gold was over 800 in 1980. What does it mean? I think that many people thought that the way around the "no income from the metal" problem was simply to buy the stocks. These share holders are still bullish, and it's almost as if they don't see the bullion dropping below 380. Thus, I consider the high gold share price level a contrary opinion. To me it implies an almost religious belief that the metal must rise–thus justifying the price of the shares!

But suppose the opposite is true? Suppose the metal is defining the true trend of gold, and suppose the shares are somewhere in dreamland? What then? My feeling is that if the metal is defining a primary bear market in gold, then we could be near a panic in the gold shares. Put it this way– a gold share panic would not surprise me.

"But what about inflation?" I am asked. And my answer is, "I don't believe we are facing inflation, but even if we are there is no guarantee that gold has to go up. There is no guaranteed ratio between gold and inflation. Maybe this time foreign currencies or who knows what will go up in the face of inflation. Certainly, the chart of gold now shows me nothing. Leading me to believe that we are either (1) facing deflation, or (2) we are facing a different market reaction to inflation.

This chart (courtesy of Chartcraft, Larchmont, NY) has been shown here repeatedly and it has been invaluable in showing me the picture for gold. Note that gold has been fluctuating below the main or primary bearish trendline (marked "a" on the chart). Gold has also broken below the main bullish trendline, marked "b" on the chart. A new bear signal will be given on an afternoon London fix of 364. For the bulls, it will require a PM London fix of 408 to signal a turn to the upside.



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